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Date October 22, 1996

Signature [REDACTED]

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Employer Identification Number: [REDACTED]

Dear Taxpayer:

This refers to your application for recognition of exemption from federal income tax as an organization described in section 501(c)(15) of the Internal Revenue Code.

You were incorporated on [REDACTED], under the name [REDACTED]. Your name was changed to the name shown above on [REDACTED].

You state that you are an insurance company in liquidation and that your books and records are under the control of the [REDACTED] Department of Insurance. An Order of Liquidation was approved by the [REDACTED] County Superior Court on [REDACTED]. The Order terminated the writing of premiums and the issuing of policies. The Court ordered all policies canceled.

Article Two of your Articles provide that "[your purpose] is to engage in any lawful act or activity ... other than the banking business, the trust company business, or the practice of a profession permitted to be incorporated by the [REDACTED] Corporation Code."

You state that you have no open insurance policies on which you are paying claims, and that coverage on all policies written by you was terminated as of [REDACTED]. However, you state that the [REDACTED] Department of Insurance Conservation & Liquidation (hereafter CLO) is still processing open claims. However, you have failed to furnish information showing how much in claims have been paid since [REDACTED].

The 1024 exemption application represents that your premium income for [REDACTED] exceeded \$[REDACTED]. The financial data reflects that you had in excess of \$[REDACTED] in premium income for [REDACTED], and no premium income in [REDACTED].

The information furnished shows that you are a member of a controlled group (hereafter referred to as the [REDACTED]) that is composed of a number of foreign corporations. You indicate that two corporations comprising the [REDACTED] are insurance companies.

By letter dated [REDACTED], we requested additional information from you concerning your operations and activities. Also, we requested information (i) identifying the two foreign insurance companies and their shareholders; (ii) reflecting whether they had United States source income; and (iii) the amount of US premium income.

By letter dated [REDACTED], you submitted most of the information requested in our letter of [REDACTED]. However, you did not furnish the names of the two insurance companies, their shareholders, and US source income.

It appears from the material furnished that [REDACTED], a [REDACTED] corporation (hereafter [REDACTED]) and [REDACTED] (hereafter [REDACTED]) may be the two insurance companies comprising the [REDACTED].

You stated in your letter of [REDACTED], that you were attempting to determine if either of the two insurance companies are doing business in the United States, the level of U.S. premiums, if any, and the owners of the insurance companies. We have not received this information.

Section 501(c)(15)(A) of the Internal Revenue Code exempts from federal income tax insurance companies or associations other than life if the net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed \$350,000.

Section 501(c)(15)(B) of the Code provides that in determining whether any company or association is described in section 501(c)(15)(A), it is treated as receiving during the taxable year premiums which are received during such year by all other companies or associations which are members of the same controlled group as the insurance company or association for which the determination is being made.

Section 501(c)(15)(C) of the Code provides that for purposes of section 501(c)(15)(B), the term "controlled group" is defined in section 831(b)(2)(B)(ii).

Section 831(b)(2)(B)(ii) of the Code defines "controlled group" as any controlled group of corporations (as defined in section 1563(a)); except that--

(I) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a), and

(II) sections 1563(a)(4) and (b)(2)(D) shall not apply.

Section 1563(b)(1) of the Code provides that a corporation is a component member of a controlled group of corporations on a December 31 of any taxable year (and with respect to the taxable year which includes such December 31) if it is a member of such controlled group on the December 31 included in such year and is not treated as an excluded member under section 1563(b)(2).

Section 1563(a)(1) of the Code defines "controlled group of corporations" as including a parent-subsidiary controlled group. A parent-subsidiary controlled group is one or more chains of corporations connected through stock ownership with a common parent corporation if--

(A) stock possessing at least 80% of the total combined voting power of all classes of stock entitled to vote or at least 80% of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation, is owned (within the meaning of subsection (d)(1)) by one or more of the other corporations; and

(B) the common parent owns (within the meaning of subsection (d)(1)) stock possessing at least 80% of the total combined voting power of all classes of stock entitled to vote or at least 80% of the total value of shares of all classes of stock of at least one of the other corporations, excluding, in computing such voting power of value, stock owned directly by such other corporations.

Based on the information furnished it appears that you are part of a parent-subsidiary controlled group of corporations as defined above. Thus, the question is whether any of the controlled group members are treated as excluded members.

Section 1563(b)(2)(C) of the Code provides that a member on December 31 shall be treated as an excluded member for the taxable year including such December 31 if it is a foreign corporation subject to tax under section 881.

Section 1.1563-1(b)(1) of the Income Tax Regulations provides that a corporation which is a member of a controlled

group of corporations on any December 31 shall be treated as an excluded member of such group on such date if it is a foreign corporation not subject to taxation under section 882(a).

However, we do not believe that section 1563(b)(2)(C) was intended to exclude foreign corporations on their income effectively connected with the conduct of a trade or business in the United States ("ECI"). In enacting the controlled group rules under section 1563, Congress intended to include in controlled groups corporations whose income tax is determined in whole or in part by reference to the normal and surtax rates in the Code, but not exempt organizations which do not have unrelated business income and foreign corporations which are subject to a flat rate tax on their income from sources within the United States. See H.R. Rep. No. 749, 88th Cong, 1st Sess. (1964), reprinted in 1964-1 C.B. 244.

Section 881 of the Code imposes a flat rate tax of 30% on the gross amount of certain types of income received from sources within the United States by a foreign corporation, but only to the extent that the amount received is not ECI. Section 882(a), by contrast, generally provides that a foreign corporation engaged in trade or business within the United States during the taxable year is taxable as provided in section 11, 55, 59A, or 1201 on its taxable ECI. Section 882(c) generally allows deductions and credits to a foreign corporation in determining its taxable ECI. Thus, section 882(a) is a tax on net income, determined with reference to section 11.

Section 11(a) of the Code generally imposes a tax on the taxable income of every corporation. Section 11(c)(2) provides that section 11(a) shall not apply to a corporation subject to subchapter L (section 801 et seq., relating to insurance companies). Section 801 generally imposes a tax on the life insurance company taxable income of every life insurance company, computed as provided in section 11 as though the "life insurance company taxable income" were the "taxable income" referred to in section 11 or, in some situations, computed with reference to sections 11 and 1201. Section 831 generally provides that taxes computed as provided in section 11 shall be imposed on the taxable income of every insurance company other than a life insurance company, with an alternative tax for certain electing small insurance companies. Thus, the income tax of insurance companies taxable under subchapter L is determined with regard to the normal corporate rates in section 11, with certain modifications made for determining their taxable income.

Section 842(a) of the Code generally provides that if a foreign company carrying on an insurance business within the United States would be taxable under subchapter L if (regarding only ECI) it were a domestic corporation, such company is taxable under such part on its ECI. With respect to the rest of its income from sources within the United States, such company is taxable as provided in section 881.

Thus a foreign insurance company with ECI, is subject to the normal and surtax rates of tax on its taxable ECI, and not merely to a flat rate tax on its U.S. source income under section 881. Since a foreign insurance company with ECI, is taxable under section 882(a) of the Code, it cannot be regarded as an excluded member of the controlled group by virtue of section 1563(b)(2)(C). Such interpretation is also consistent with Congressional intent to limit the benefit of section 501(c)(15) exemption to "small" insurance companies which do not have large controlled group members. See H.R. Rep. No. 426, 99th Cong., 1st Sess. (1985), reprinted in 1986-3 C.B. (Vol. 2) 677; Sen. Rep. No. 313, 99th Cong., 2d Sess. (1986), reprinted in 1986-3 C.B. (Vol. 3) 511.

Accordingly, because we have not received any of the information about the two foreign insurance companies that we requested in our letter to you of [REDACTED], we must assume that the two foreign insurance companies had ECI in [REDACTED] and [REDACTED]. Further, we must assume that such premium income, when combined with your premium income for [REDACTED] and [REDACTED], exceeded the \$350,000 threshold limit under section 501(c)(15) of the Code.

Therefore, based on the above, we conclude that you do not qualify for recognition of exemption from federal income tax under 501(c)(15) of the Code. You must file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days of the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

[REDACTED]

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key District Director, Western, which is located in Los Angeles, California. Thereafter, any question about your federal income status should be addressed to that office.

Sincerely yours,

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[REDACTED]
Chief, Exempt Organizations
Technical Branch 3

cc: DD, Western (Los Angeles)
Attn: EO Group

cc: [REDACTED]